

**Liberty Utilities (CalPeco Electric) LLC (U 933-E)**  
**General Rate Case (A.15-05-008)**

**Exhibit 9 – Supplemental Testimony**  
**Chapter 1 – Alain R. Blunier**

**Liberty Utilities (CalPeco Electric) LLC (U 933-E)**  
**General Rate Case (A.15-05-008)**

**Exhibit 9 – Supplemental Testimony**  
**Chapter 1 – Alain R. Blunier**

**I. INTRODUCTION AND SUMMARY**

**1. Q: Please state your name, occupation, and business address.**

A: My name is Alain R. Blunier. My primary work location address is 6891 North Lake Boulevard, Suite 122, Tahoe Vista, California 96148 and my business address is 933 Eloise Avenue, South Lake Tahoe, California 96150. My title is Rate Analyst II and I provide services in this capacity for Liberty Utilities (CalPeco Electric) LLC (“Liberty Utilities”).

**2. Q: Does Exhibit 4, ARB, entitled “Witness Statement of Qualifications: Alain R. Blunier” accurately summarize your background, education, and experience?**

A: Yes, it does. I should add that I report to Kendrick E. Wittman, who is the Senior Manager, Finance, Accounting and Regulatory for Liberty Utilities. In such capacity, Mr. Wittman would normally be the sponsor of this testimony; however, as Mr. Wittman has unexpectedly been out of the office this week due to a death in the family, I am at this time sponsoring this testimony.

**3. Q: Describe the Supplemental Testimony you are currently sponsoring.**

A: The Administrative Law Judge’s Ruling Directing Submission of Supplemental Testimony (“Ruling”), issued March 30, 2016, directed applicant Liberty Utilities to respond to eight questions relating to Liberty Utilities’ use of the Safe Harbor tax election to take deductions for the repair of electric transmission and distribution property. Liberty Utilities’ responses to the eight questions are set forth in Exhibit A to my testimony.

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**II. RESPONSES**

**1. Q: Which of the responses set forth in Exhibit A are you sponsoring?**

A: I am sponsoring myself or co-sponsoring with Luisa Read, Vice President, Finance and Administration, Algonquin Power & Utilities Corp., the responses to the following questions: 1(a), 1(b), 1(c), 1(d), 1e; 2; 3, 4, 5, 6, 7, and 8(g) and Appendix 1 and Appendix 2.

**2. Q: In response to Question 1(a) in Exhibit A, Liberty Utilities states that in September 2015, it made the election to take the Safe Harbor repair deduction and, at that time, it took the repair deduction on its corporate income tax returns for 2013 and 2014. Summarize the consequences of this election by Liberty Utilities for purposes of ratemaking in general, in the context of this proceeding, and with respect to any possible required disclosures or reporting requirements independent of this proceeding.**

A: Numerous questions the Ruling poses appear predicated on two assumptions related to Liberty Utilities' election to take the Safe Harbor repair deduction. First, the Ruling assumes that Liberty Utilities would have achieved tax savings (i.e., had a reduced tax expense in 2013 and 2014) and should have reflected these assumed tax savings in its various requests in prior rate proceedings. Second, the Ruling assumes that Liberty Utilities had some obligation to formally disclose or otherwise report the election and assumed tax savings under the United States and/or Canadian securities laws and in the context of this proceeding.

As explained in the responses to the Questions set forth in Exhibit A, both of these assumptions are wrong. Independent of its election to take the Safe Harbor repair deduction and primarily due to its ability to take Bonus depreciation and the implementation of the Modified

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1 Accelerated Cost Recovery System (“MACRs”), Liberty Utilities would have had for income tax  
2 purposes a Net Operating Loss in both 2013 and 2014. Thus, while its taking of the repair  
3 deduction did reduce taxable income in both 2013 and 2014, the reduction did not reduce any  
4 actual tax expense or liability (i.e., Liberty Utilities’ tax expense for both 2013 and 2014, both  
5 before and after taking the repair deduction, remained at \$0). Thus Liberty Utilities’ September  
6 2015 election had no direct impact on rates to be requested or authorized in 2013, 2014, or 2015.

7 With respect to rates to be authorized effective as of January 1, 2016 (i.e., the issue in this  
8 proceeding), Liberty Utilities has provided the Office of Ratepayer Advocates (“ORA”) and the  
9 A-3 Customer Coalition, the lone intervenor in this proceeding, with an updated revenue  
10 requirement model. This updated model incorporates the impact of Liberty Utilities’ September  
11 2015 election to take the Safe Harbor repair deduction on its federal income tax returns. Liberty  
12 Utilities and ORA are using this updated revenue requirement model to conduct settlement  
13 negotiations. In the event that the parties achieve a complete or partial settlement, Liberty  
14 Utilities intends that the settlement agreement and corresponding motion to request approval of  
15 the settlement address the election made by Liberty Utilities to take the Safe Harbor repair  
16 deduction.

17 Liberty Utilities’ September 2015 election to take the Safe Harbor repair deduction does  
18 not represent the type of change in accounting method that triggers any disclosure obligation  
19 under United States or Canadian securities laws. With respect to this General Rate Case  
20 proceeding, during the normal course of discovery and informal communications, Liberty  
21 Utilities did timely advise ORA of Liberty Utilities’ September 2015 election to take the Safe

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Harbor repair deduction. Moreover, as stated in the preceding paragraph, the current revenue requirement model that Liberty Utilities and ORA are using to structure a possible settlement incorporates Liberty Utilities' election to take the Safe Harbor repair deduction for purposes of its federal income tax returns. *See* Appendix 1 to Exhibit A to this testimony.

**III. CONCLUSION**

**1. Q: Does this conclude your supplemental testimony?**

A: Yes, it does.

# EXHIBIT A

**LIBERTY UTILITIES' RESPONSES TO THE QUESTIONS  
POSED IN THE ADMINISTRATIVE LAW JUDGE'S  
MARCH 30, 2016 RULING DIRECTING SUBMISSION OF  
SUPPLEMENTAL TESTIMONY**

## **Liberty Utilities (CalPeco Electric) LLC (U 933-E)**

### **Application 15-05-008**

#### **Exhibit A**

Applicant Liberty Utilities (CalPeco Electric) LLC (“Liberty Utilities”) submits the following responses to the questions set forth in the March 30, 2016 Administrative Law Judge Ruling Directing Submission of Supplemental Testimony (“March 30 Ruling”).

**Question 1:** Did Liberty take the Safe Harbor repair deductions? If yes, please answer Questions (a) through (d).

- a) What tax years did Liberty take the repair deductions?
- b) What were the annual decreases in tax expense for each of the years where the repair deductions were taken?
- c) Was the decrease in tax expenses reflected in any of Liberty’s Post Test Attrition Mechanism?
- d) Was the decrease in tax expenses forecasted and therefore reflected in Liberty’s Test Year 2012 General Rate Case (GRC)?
- e) If the answer to Question (c) was “No,” what did Liberty do with the tax savings?

#### **Response to Question 1:**

Yes. Liberty Utilities did make the election to take the Safe Harbor repair deduction.

a) As stated in the March 30 Ruling, Revenue Procedure (Rev. Proc.) 2011-43 was released on August 18, 2011 and it allows taxpayer electric utilities to elect a Safe Harbor method of accounting for repair of electric transmission and distribution property. However, the final regulations authorizing implementation of Rev. Proc. 2011-43 became fully effective in 2014 and thus the opportunity to elect the Safe Harbor repair deduction was first germane to Liberty Utilities in its preparation of its tax return for 2014.

Liberty Utilities made in September 2015 the election to take the Safe Harbor repair deduction for its 2014 tax year filing. In this 2014 tax year filing, Liberty Utilities also made a Section 481(a) election to reflect its election to take the Safe Harbor repair deduction for its tax year 2013.

b) The adjusted decreases in taxable income associated with the taking of the repair deductions were \$3,122,070 and \$3,258,581, for 2013 and 2014, respectively.

However, these increases in deductions and corresponding decreases in taxable income did not affect that amount of taxes Liberty Utilities was obligated to pay for either 2013 or 2014. In each year, even before electing to take the repair deduction, Liberty Utilities had a Net Operating Loss, in part based on Liberty Utilities ability to take Bonus depreciation in each of these tax years. Thus the further decrease in taxable income associated with the Safe Harbor repair deduction did not impact the amount of tax payments Liberty Utilities made in either year.

c) No. As explained in response to (b) above, Liberty Utilities' election in 2015 to take the repair deductions did not decrease any tax expense for either 2013 or 2014. After election of the repair deduction, Liberty Utilities' tax payment for each 2013 and 2014 remained at \$0. Thus there were no decreases in tax expenses to reflect in the Post-Test Year Adjustment Mechanism ("PTAM") filings Liberty Utilities submitted in October 2013 with a requested effective date of January 1, 2014, or in the PTAM filing Liberty Utilities submitted in October 2014 with a requested effective date of January 1, 2015.

In any event, even assuming the September 2015 election to take the repair deduction would have resulted in Liberty Utilities making lesser tax payments in 2013 or 2014, Liberty Utilities' PTAM tariff does not provide for changes in tax expenses (either increases or decreases) to be reflected in PTAM filings. Liberty Utilities' PTAM tariff allows adjustments based strictly on two factors: (i) Attrition Rate Factor Component: based on the current year's September Global Insight U.S. Economic Outlook for the Consumer Price Index, minus a 0.5% productivity factor; and (ii) Major Plant Addition Component: the overall revenue requirement (including the associated operation and maintenance expenses, depreciation, and property taxes) associated with any capital project closed to plant-in-service that exceeds \$4 million in a calendar year.

Lastly, even if Liberty Utilities' election to take the tax repair deduction would have resulted in lower tax expenses in 2013 and 2014, and further assuming its PTAM tariff authorized Liberty Utilities to reflect such lower tax expenses in its PTAM request, Liberty Utilities submitted its PTAM filings for 2014 and 2015 before it made the repair deduction election in September 2015.

d) No. As its submission (Application 12-02-014) and the ultimate settlement of Liberty Utilities' 2013 general rate case application ( approved in D. 12-11-030) preceded Liberty Utilities September 2015 election to take the Safe Harbor repair deduction, the Safe Harbor repair deduction was neither forecasted nor otherwise reflected in Liberty Utilities' Test Year 2013 general rate case proceeding.

e) Not applicable. Liberty Utilities' election of the repair deduction for 2013 and 2014 reduced taxable income in each year by increasing the amount of deductions; however, given that Liberty Utilities independently had a Net Operating Loss for each year, the election of the repair deduction did not generate any "tax savings" for either year (i.e., in each year, Liberty Utilities' tax liability remained at \$0).



**Question 2:** Please provide the federal and state repair allowance and repair deduction taken by Liberty with respect to operations and property subject to California regulation in each year beginning with the Sierra Power acquisition and continuing through the most recent period for which tax data is available.

**Response to Question 2:**

Table 1 below sets forth the repair allowance and repair deductions taken by Liberty Utilities on both its federal and state tax returns with respect to operations and property subject to California regulation for the tax years 2011, 2012, 2013, and 2014.

**TABLE 1**

Actual Repair Deductions				Forecast Repair Deductions	
2011	2012	2013	2014	2015	2016
\$0	\$0	\$3,122,070	\$3,258,587	\$5,292,276	\$5,070,551

**Question 3:** Please provide the latest available forecasts of repair deductions as well as copies of all securities filings, Canadian or American, which relate to the change in accounting method.

**Response to Question 3:**

The latest available forecasts for repair deductions that Liberty Utilities will take on its returns for its 2015 and 2016 tax years are set forth in Table 1 above.

A taxpayer's election to take the Safe Harbor deduction for repair and replacement expenses does not constitute a change in accounting method that triggers any disclosure or special reporting under any Canadian or American securities regulations and thus there are no documents responsive to this request.

**Question 4:** Regarding the prior treatment of repair deductions prior to the safe harbor method accounting change:

a) Before Liberty increased its repair deductions as a consequence of the change in accounting method, would those costs that are not part of the increased repair deductions instead have been capitalized for tax purposes and subsequently depreciated? If so, would taxes have been normalized on those costs creating a deferred tax adjustment to rate base?

b) If the answer to part (a) is anything other than an unqualified negative, what percentage of those costs that became currently-deductible repair costs would have been eligible for Bonus depreciation in subsequent years? Please provide specific percentages and dollar amounts for each applicable tax year.

c) Did Liberty take Internal Revenue Code (IRC) Section 481(a) adjustments? If so, how was IRC § 481a implemented? What were the resulting differences between book and tax depreciation as a result of IRC §481a (please also clarify for any effects of prior year Bonus depreciations)? Were the resulting differences between book and tax depreciation recorded in Liberty's accumulated deferred income tax account (an offset to rate base)?

**Response to Question 4:**

a) Yes. Those repair costs that would not have been accounted for in the increased repair deduction would have been capitalized for tax purposes and subsequently depreciated.

Yes. Those repair costs that would not have been accounted for in the increased repair deductions would have been normalized creating a deferred tax adjustment to rate base.

b) For tax years 2013 to 2017, the qualifying taxpayer may take Bonus depreciation on 50% of the asset additions. Bonus depreciation decreases to 40% of the asset additions in 2018 and to 30% in 2019.

c) Yes. Liberty Utilities did make a Section 481(a) adjustment for its tax year 2013 on the 2014 tax return it filed in September 2015. Thus the net effect of the increase in the 2013 repair deduction was incorporated in the 2014 tax return.

Table 2 below sets forth the amount of repair deduction that Liberty Utilities took in its 2013 and 2014 tax years and is forecasting for 2015 and the Bonus depreciation and Modified Accelerated Cost Recovery System ("MACRs") depreciation that Liberty Utilities could have taken in those tax years in lieu of making the election to take the Safe Harbor repair deduction.

<b>TABLE 2</b>			
<u>Year</u>	<u>Repair Cost</u>	<u>Bonus Depreciation</u>	<u>Depreciation Expense</u>
2013	\$3,122,070	\$1,561,035	\$58,539
2014	\$3,258,587	\$1,629,294	\$61,099
2015	\$5,292,276	\$2,646,138	\$99,230

Yes. The resulting differences between book and tax depreciation triggered by the Safe Harbor election to take the repair deduction was recorded in Liberty Utilities' Accumulated Deferred Income Tax account and created an offset to rate base.

**Question 5:** Regarding the ratemaking treatment of repair deductions prior to Test Year 2016, were the repair deductions in excess of the amount forecast in prior GRCs flowed through to shareholders?

a) If the repair deductions were flowed through to shareholders between rate cases, did ratepayers receive smaller reductions to rate base from Accumulated Deferred Income Tax over the applicable depreciable period?

b) If the repair deductions were flowed to shareholders between rate cases, will Liberty claim smaller depreciation expense deductions and hence increase the tax expense of ratepayers in future years? If so, how far in the future would this occur?

c) If the repair deductions were flowed to shareholders between rate cases, would the reductions in rate base offset and depreciation expense increase rates, assuming all else is constant?

**Response to Question 5:**

a) As explained in response to Question 1, Liberty Utilities' election in September 2015 to take the Safe Harbor repair deduction did not reduce its tax liability for either 2013 or 2014. Thus no repair deductions "were flowed to shareholders between rate cases."

b) As explained in response to Question 1, Liberty Utilities' election in September 2015 to take the Safe Harbor repair deduction did not reduce its tax liability for either 2013 or 2014. Thus no repair deductions "were flowed to shareholders between rate cases."

c) As explained in response to Question 1, Liberty Utilities' election in September 2015 to take the Safe Harbor repair deduction did not reduce its tax liability for either 2013 or 2014. Thus no repair deductions "were flowed to shareholders between rate cases."

**Question 6:** Please explain why Liberty did not disclose the safe harbor election in its testimony or provide updates relating to it.

**Response to Question 6:**

Application 15-05-008, including the direct testimony served concurrently with the Application, does not reference Liberty Utilities election to take the Safe Harbor repair deduction because, as explained in Response to Question 1, Liberty Utilities made the election to take the Safe Harbor repair deduction in September 2015, four months after its May 1, 2015 filing of Application 15-05-008.

Further, the assumption underlying Question 6 that Liberty Utilities provided no update to disclose its election is erroneous. Shortly after making the election to take the Safe Harbor repair deduction, and several weeks before ORA's submission of its Phase 1 testimony on November 9, 2015, Liberty Utilities disclosed its election to ORA. On October 23, 2015 in a written response to an ORA Data Request, Liberty Utilities reported that in September 2015 it

had made the election to take the Safe Harbor repair expense. A copy of Liberty Utilities' response to Request 2 to the ORA-065-MPS Data Requests is attached as Appendix 1.

Liberty Utilities' response explained that it had been determined that Liberty Utilities had sufficient qualifying expenditures to elect to deduct its repair expenses for 2013 and 2014, that it had included the repair deductions in its 2014 corporate income tax return (filed in September 2015), and that Liberty Utilities had also incorporated the revised repair deductions for 2013 by making a Section 481(a) adjustment on its 2014 corporate income tax return. Moreover, and as reported in its response to Request 2 in the ORA-065-MPS Data Requests, on October 19, 2015, Liberty Utilities met with ORA and, among other topics, explained how its election to take the repair deduction could be integrated into the then-current version of Liberty Utilities' revenue requirement model.

Liberty Utilities provided the A-3 Customer Coalition, the only other party in this proceeding, a copy of the ORA-065-MPS Data Requests on October 16, 2015. The A-3 Customer Coalition did not request that Liberty Utilities provide the A-3 Customer Coalition a copy of Liberty Utilities' response to Request 2 in ORA-065-MPS.

In its Phase 1 testimony submitted November 9, 2015, ORA raised no issue relating to depreciation in general and no issue with respect to the September 2015 election by Liberty Utilities to take the Safe Harbor repair deduction. Accordingly, Liberty Utilities had no reason to address the Safe Harbor repair tax election in its rebuttal testimony served on December 7.

In any event, the consequences of Liberty Utilities' September 2015 election to deduct the repair expense on its federal tax returns are incorporated in the current revenue requirement model Liberty Utilities and ORA are using for purposes of settlement negotiations. Assuming that the parties are able to reach a complete or partial settlement in the general rate case proceeding, Liberty Utilities intends that the settlement agreement and the corresponding motion requesting approval of the settlement agreement address Liberty Utilities' September 2015 election to deduct repair expenses.

**Question 7:** Regarding the impacts on 2016 rates from the safe harbor election:

a) Please provide calculations with supporting work papers showing the difference in Accumulated Deferred Income Tax balance each year from 2011-2044 that would have resulted if Liberty had continued to use its prior accounting method (e.g. percentage repair allowance) from 2011-2015. The calculation should be consistent with GRC forecasts of capital spending. The end year of the analysis may not be earlier than 2016 but may be earlier than 2044 depending on the feasibility of the analysis and on the depreciable lives of the affected units of property. If an earlier end year is selected, please explain why.

b) Please provide calculations with supporting work papers showing the total difference between book and tax depreciation in each year from 2011-2044 that would have resulted if Liberty had continued to use its prior accounting method (e.g. percentage repair allowance) from 2011-2015. The calculation should be consistent with GRC forecasts of capital spending. Please clarify any impacts of Bonus depreciation. The end year of the analysis may not

be earlier than 2016 but may be earlier than 2044 depending on the feasibility of the analysis and on the depreciable lives of the affected units of property. If an earlier end year is selected, please explain.

**Response to Question 7:**

- a) The requested calculations are contained in Appendix 2.
- b) The requested calculations are contained in Appendix 2.

**Question 8:** Please answer the following:

- a) When did Liberty first become aware that an increased repair deduction could potentially be available?
- b) When did Liberty file its Form 3115 with the IRS to elect the safe harbor method of accounting?
- c) When did Liberty decide to make the change in accounting method?
- d) When was Liberty's change in accounting method first disclosed to or discoverable by any outside party? To or by investors? To or by any American or Canadian regulatory body, including securities regulators?
- e) Please describe the process by which Liberty decided to elect the safe harbor. The discussion should include, but not be limited to, identification of the persons who provided material input and the dates of each step of the determination. Please also provide any relevant internal memoranda or other related documents.
- f) Please identify each corporate officer who reviewed or ultimately approved any decision to implement the changes to the repair deduction, and the approximate date of that review or approval.
- g) Please provide any relevant memoranda or other documents addressing which regulatory bodies or other entities or persons should be advised of the safe harbor election or related decrease in tax expense.

**Response to Question 8:**

- a) Liberty Utilities first became generally aware that a deduction for up to 100% of the repair expenses could potentially be available sometime after the initial issuance of Rev. Proc. 2011-43 in August 2011. However, as explained in Response to Question 1, the final regulations allowing taxpayer electric utilities to make the Safe Harbor repair deduction election became effective in 2014 and Liberty Utilities filed its 2014 tax return in September 2015.

b) Liberty Utilities filed its Form 3115 with the IRS to elect the Safe Harbor repair deduction on September 15, 2015.

c) Liberty Utilities elected the Safe Harbor repair deduction for purposes of submitting its 2014 tax return on September 15, 2015.

d) As stated in its response to Question 3, Liberty Utilities' election of the Safe Harbor repair deduction did not trigger any need to make a separate disclosure for purposes of compliance with the United States or Canadian securities laws. As set forth in response to Question 6, Liberty Utilities disclosed its election to take the Safe Harbor repair deduction to ORA in October 2015 and before ORA submitted its Phase 1 testimony in this proceeding.

e) Liberty Utilities decided to elect the Safe Harbor repair deduction based on discussions with, and analysis provided by, its external tax advisors, Ernst & Young. In the latter part of 2014, Liberty Utilities engaged Ernst & Young to perform a Phase I study to assess the possible benefits of Liberty Utilities electing the Safe Harbor repair deduction, the level of effort involved to achieve compliance, and the magnitude of any possible Section 481(a) adjustments.

Attached in Appendix 3 are excerpts from two documents prepared by Ernst & Young that form the basis for the election Liberty Utilities ultimately made in September 2015: (i) Liberty Utilities Co. Tangible Property Regulations Phase I – Assessment Summary, April 7, 2015; and (ii) Liberty Utilities (America) Co. Tangible Property Regulations – Process Memorandum, dated January 6, 2016.<sup>1</sup>

f) David Bronicheski, Chief Financial Officer for Liberty Utilities (America) Co. submitted the 2014 tax return and also executed the IRS Form 3115. Luisa Read, Vice President, Finance and Administration, Algonquin Power & Utilities Corp was the primary person working with Ernst & Young and assisting Mr. Bronicheski with respect to the analysis and recommendations relating to Liberty Utilities' ultimate decision in September 2015 to make the election to take the Safe Harbor repair deduction.

g) Given that the election to take the Safe Harbor repair expenses represents a change a change in tax policy which allowed Liberty Utilities to increase its deductions for repair expenses and that existing ratemaking protocols provide the procedures by which such changes in tax liability are to be reflected in ratemaking, there are no documents assessing the possible need to make any special filing or separate disclosure relating to the Safe Harbor election.

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<sup>1</sup> Appendix 2 includes excerpts from these documents that relate to Liberty Utilities' ultimate election in September 2015 to take the Safe Harbor repair deduction. Portions of these documents that relate to other tax-related issues are not responsive to Question 8 and have thus not been included.

# APPENDIX 1

**RESPONSE OF LIBERTY UTILITIES (CALPECO ELECTRIC)  
LLC (U 933-E) TO OFFICE OF RATEPAYER ADVOCATES  
REQUEST 2 IN THE ORA-065-MPS DATA REQUESTS**

**BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF CALIFORNIA**

Application of Liberty Utilities (CalPeco Electric) LLC (U 933-E) for Authority to Among Other Things, Increase Its Authorized Revenues For Electric Service, Update Its Energy Cost Adjustment Clause Billing Factors, Establish Marginal Costs, Allocate Revenues, And Design Rates, as of January 1, 2016.

Application No. 15-05-008  
(Filed May 1, 2015)

**RESPONSE OF LIBERTY UTILITIES (CALPECO ELECTRIC) LLC (U 933-E) TO  
OFFICE OF RATEPAYER ADVOCATES DATA REQUEST NO: ORA-065-MPS**

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Attorneys for Liberty Utilities (CalPeco Electric) LLC



**Liberty Utilities (CalPeco Electric) LLC**

**RESPONSE TO ORA DATA REQUEST**

<b>DOCKET NO.:</b>	A.15-05-008	<b>REQUEST DATE:</b>	October 9, 2015
<b>REQUEST NO.:</b>	ORA-O65-MPS	<b>RESPONSE DATE:</b>	October 23, 2015
<b>REQUESTER:</b>	ORA	<b>RESPONDER:</b>	Alain Blunier/ Mike Long

**EXHIBIT REFERENCE:** Exhibit 1 – Summary and Results of Operations

**SUBJECT:** Chapter 4 – Income Tax and Other Taxes  
Chapter 9 – Revenue Requirement

**Please provide the following: All excel spreadsheets and electronic files via email and CD for income tax and other taxes.**

**REQUEST 2:**

Please provide a detailed explanation why Liberty has not taken the Repairs Deduction associated with capital investments?

- a. If Liberty is not planning to take this deduction for TY 2016, please explain in detail why?
- b. Please point out where the repair deduction can be included within the R/O model.

**CONFIDENTIAL (yes or no):** No

**RESPONSE:**

The Repairs Deduction was not included in Liberty Utilities' 2016 General Rate Case ("GRC") because at the time the GRC was being prepared, it had not been determined if Liberty Utilities had any expenditures that qualified for the Repairs Deduction. Subsequently, Liberty Utilities has determined that it did have qualifying expenditures for the Repairs Deductions and has included those deductions in its 2014 U.S. Corporate Income Tax Return and has amended its 2013 U.S. Corporate Income Tax Return.

- a. If Liberty Utilities has qualifying expenditures, the Company will be taking the Repairs Deduction on its 2016 U.S. Corporate Income Tax Return.
- b. In a meeting between Liberty Utilities' staff and the ORA staff on Monday, October 19, 2015 it was discussed how the Repair Deduction can be entered into Liberty Utilities' revenue requirement model.

# APPENDIX 2

## **CALCULATIONS RESPONDING TO QUESTION 7**

Liberty Utilities (CalPeco Electric) LLC  
Repair Deduction Eliminated - Book Depreciation vs Tax Depreciation and ADIT Impact

2013									Tax Rate 39.8344%
Amount of Repair Deduction	Book Depreciation (1)	Book Basis	Tax Depreciation			Tax Basis	Difference	ADIT	
			Bonus	Annual (2)	Total				
2013	3,122,070	54,013	3,068,057	1,561,035	58,539	1,619,574	1,502,496	(1,565,561)	(623,632)
2014		54,013	3,014,044		112,691	112,691	1,389,805	(1,624,239)	(647,006)
2015		54,013	2,960,031		104,230	104,230	1,285,575	(1,674,456)	(667,010)
2016		54,013	2,906,018		96,425	96,425	1,189,150	(1,716,868)	(683,904)
2017		54,013	2,852,005		89,182	89,182	1,099,968	(1,752,037)	(697,913)
2018		54,013	2,797,992		82,501	82,501	1,017,467	(1,780,525)	(709,261)
2019		54,013	2,743,979		76,303	76,303	941,164	(1,802,815)	(718,141)
2020		54,013	2,689,966		70,590	70,590	870,574	(1,819,392)	(724,744)
2021		54,013	2,635,952		69,653	69,653	800,920	(1,835,032)	(730,974)
2022		54,013	2,581,939		69,638	69,638	731,282	(1,850,657)	(737,198)
2023		54,013	2,527,926		69,653	69,653	661,629	(1,866,297)	(743,428)
2024		54,013	2,473,913		69,638	69,638	591,991	(1,881,922)	(749,652)
2025		54,013	2,419,900		69,653	69,653	522,338	(1,897,562)	(755,883)
2026		54,013	2,365,887		69,638	69,638	452,700	(1,913,187)	(762,107)
2027		54,013	2,311,874		69,653	69,653	383,047	(1,928,827)	(768,337)
2028		54,013	2,257,861		69,638	69,638	313,409	(1,944,452)	(774,561)
2029		54,013	2,203,848		69,653	69,653	243,756	(1,960,092)	(780,791)
2030		54,013	2,149,835		69,638	69,638	174,118	(1,975,717)	(787,015)
2031		54,013	2,095,822		69,653	69,653	104,464	(1,991,357)	(793,245)
2032		54,013	2,041,809		69,638	69,638	34,827	(2,006,982)	(799,469)
2033		54,013	1,987,796		34,827	34,827	(0)	(1,987,796)	(791,827)
2034		54,013	1,933,783					(1,933,783)	(770,311)
2035		54,013	1,879,770					(1,879,770)	(748,795)
2036		54,013	1,825,757					(1,825,757)	(727,279)
2037		54,013	1,771,744					(1,771,744)	(705,763)
2038		54,013	1,717,730					(1,717,730)	(684,248)
2039		54,013	1,663,717					(1,663,717)	(662,732)
2040		54,013	1,609,704					(1,609,704)	(641,216)
2041		54,013	1,555,691					(1,555,691)	(619,700)
2042		54,013	1,501,678					(1,501,678)	(598,185)
2043		54,013	1,447,665					(1,447,665)	(576,669)
2044		54,013	1,393,652					(1,393,652)	(555,153)
			<u>1,728,418</u>		<u>1,561,035</u>	<u>1,561,035</u>	<u>3,122,070</u>		
Book/Tax Basis at 2044			<u>1,393,652</u>					<u>(0)</u>	

**(1) CPUC Approved Depreciation Rate for FERC Account 364 (Poles, Towers and Fixtures)**

**(2) Tax Depreciation Rate for FERC 364**

MACRS20

3.750%  
7.219%  
6.677%  
6.177%  
5.713%  
5.285%  
4.888%  
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4.461%  
4.462%  
4.46%  
2.23%

2014									
	Amount of Repair Deduction	Book Depreciation (1)	Book Basis	Tax Depreciation			Tax Basis	Difference	Tax Rate 39.8344% ADIT
				Bonus	Annual (2)	Total			
2013									
2014	3,258,587	56,375	3,202,212	1,629,294	61,099	1,690,392	1,568,195	(1,634,017)	(650,901)
2015		56,375	3,145,837		117,619	117,619	1,450,576	(1,695,261)	(675,297)
2016		56,375	3,089,462		108,788	108,788	1,341,788	(1,747,674)	(696,175)
2017		56,375	3,033,088		100,641	100,641	1,241,147	(1,791,941)	(713,809)
2018		56,375	2,976,713		93,082	93,082	1,148,065	(1,828,647)	(728,431)
2019		56,375	2,920,338		86,108	86,108	1,061,957	(1,858,381)	(740,275)
2020		56,375	2,863,963		79,640	79,640	982,317	(1,881,646)	(749,542)
2021		56,375	2,807,588		73,677	73,677	908,641	(1,898,947)	(756,434)
2022		56,375	2,751,213		72,699	72,699	835,942	(1,915,272)	(762,937)
2023		56,375	2,694,838		72,683	72,683	763,259	(1,931,580)	(769,433)
2024		56,375	2,638,464		72,699	72,699	690,560	(1,947,904)	(775,936)
2025		56,375	2,582,089		72,683	72,683	617,877	(1,964,212)	(782,432)
2026		56,375	2,525,714		72,699	72,699	545,178	(1,980,536)	(788,935)
2027		56,375	2,469,339		72,683	72,683	472,495	(1,996,844)	(795,431)
2028		56,375	2,412,964		72,699	72,699	399,796	(2,013,168)	(801,933)
2029		56,375	2,356,589		72,683	72,683	327,113	(2,029,476)	(808,430)
2030		56,375	2,300,214		72,699	72,699	254,414	(2,045,800)	(814,932)
2031		56,375	2,243,840		72,683	72,683	181,731	(2,062,108)	(821,428)
2032		56,375	2,187,465		72,699	72,699	109,032	(2,078,432)	(827,931)
2033		56,375	2,131,090		72,683	72,683	36,350	(2,094,740)	(834,427)
2034		56,375	2,074,715		36,350	36,350	(0)	(2,074,715)	(826,450)
2035		56,375	2,018,340					(2,018,340)	(803,994)
2036		56,375	1,961,965					(1,961,965)	(781,537)
2037		56,375	1,905,590					(1,905,590)	(759,081)
2038		56,375	1,849,216					(1,849,216)	(736,624)
2039		56,375	1,792,841					(1,792,841)	(714,167)
2040		56,375	1,736,466					(1,736,466)	(691,711)
2041		56,375	1,680,091					(1,680,091)	(669,254)
2042		56,375	1,623,716					(1,623,716)	(646,798)
2043		56,375	1,567,341					(1,567,341)	(624,341)
2044		56,375	1,510,966					(1,510,966)	(601,884)
		<u>1,747,621</u>		<u>1,629,294</u>	<u>1,629,294</u>	<u>3,258,587</u>			
Book/Tax Basis at 2044			<u>1,510,966</u>					<u>(0)</u>	

(1) CPUC Approved Depreciation Rate for FERC Account 364 (Poles, Towers and Fixtures)

(2) Tax Depreciation Rate for FERC 364 MACRS20

- 3.750%
- 7.219%
- 6.677%
- 6.177%
- 5.713%
- 5.285%
- 4.888%
- 4.522%
- 4.462%
- 4.461%
- 4.462%
- 4.461%
- 4.462%
- 4.461%
- 4.462%
- 4.461%
- 4.462%
- 4.461%
- 4.462%
- 2.23%

2015								
Amount of Repair Deduction	Book Depreciation (1)	Book Basis	Tax Depreciation			Tax Basis	Difference	Tax Rate
			Bonus	Annual (2)	Total			39.8344% ADIT
2013								
2014								
2015	5,292,276	91,558	2,646,138	99,230	2,745,368	2,546,908	(2,653,810)	(1,057,129)
2016		91,558		191,025	191,025	2,355,883	(2,753,276)	(1,096,751)
2017		91,558		176,683	176,683	2,179,200	(2,838,400)	(1,130,660)
2018		91,558		163,452	163,452	2,015,749	(2,910,293)	(1,159,298)
2019		91,558		151,174	151,174	1,864,575	(2,969,909)	(1,183,045)
2020		91,558		139,848	139,848	1,724,726	(3,018,199)	(1,202,281)
2021		91,558		129,343	129,343	1,595,383	(3,055,983)	(1,217,333)
2022		91,558		119,658	119,658	1,475,725	(3,084,083)	(1,228,526)
2023		91,558		118,071	118,071	1,357,654	(3,110,596)	(1,239,087)
2024		91,558		118,044	118,044	1,239,610	(3,137,081)	(1,249,638)
2025		91,558		118,071	118,071	1,121,539	(3,163,593)	(1,260,198)
2026		91,558		118,044	118,044	1,003,495	(3,190,079)	(1,270,749)
2027		91,558		118,071	118,071	885,424	(3,216,591)	(1,281,310)
2028		91,558		118,044	118,044	767,380	(3,243,077)	(1,291,860)
2029		91,558		118,071	118,071	649,309	(3,269,589)	(1,302,421)
2030		91,558		118,044	118,044	531,265	(3,296,075)	(1,312,972)
2031		91,558		118,071	118,071	413,194	(3,322,587)	(1,323,533)
2032		91,558		118,044	118,044	295,150	(3,349,073)	(1,334,083)
2033		91,558		118,071	118,071	177,080	(3,375,585)	(1,344,644)
2034		91,558		118,044	118,044	59,035	(3,402,071)	(1,355,195)
2035		91,558		59,035	59,035	0	(3,369,548)	(1,342,239)
2036		91,558					(3,277,989)	(1,305,767)
2037		91,558					(3,186,431)	(1,269,296)
2038		91,558					(3,094,872)	(1,232,824)
2039		91,558					(3,003,314)	(1,196,352)
2040		91,558					(2,911,755)	(1,159,880)
2041		91,558					(2,820,197)	(1,123,408)
2042		91,558					(2,728,638)	(1,086,937)
2043		91,558					(2,637,080)	(1,050,465)
2044		91,558					(2,545,521)	(1,013,993)
		<u>2,746,755</u>	<u>2,646,138</u>	<u>2,646,138</u>	<u>5,292,276</u>			
Book/Tax Basis at 2044		<u>2,545,521</u>				<u>0</u>		

(1) CPUC Approved Depreciation Rate for FERC Account 364 (Poles, Towers and Fixtures)

(2) Tax Depreciation Rate for FERC 364

MACRS20

- 3.750%
- 7.219%
- 6.677%
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- 4.462%
- 4.46%
- 2.23%

# APPENDIX 3

- Document 1.** Pages 1 – 4 excerpted from 7-page document titled “Liberty Utilities Co. Tangible Property Regulations Phase I – Assessment Summary,” prepared by Ernst & Young LLP, dated April 7, 2015.
- Document 2.** Multipage excerpts from 13-page document entitled “Liberty Utilities (America) Co. Tangible Property Regulations – Process Memorandum,” prepared by Ernst & Young LLP, dated January 6, 2016.

**Liberty Utilities Co.  
Tangible Property Regulations  
Phase I - Assessment Summary**

**April 7, 2015**

EY was engaged by Liberty Utilities ("Liberty" or "the Company") to assist the Company with a phase I analysis of the Company's compliance with the tangible property regulations (the "Review"). The following summarizes the analysis performed and review steps.

**SUMMARY**

On September 13, 2013 and August 14, 2014, Treasury and the IRS issued tangible property regulations under provisions that include Sections 162, 167, 168 and 263(a) ("The Regulations"). The Regulations broadly apply to amounts paid to acquire, produce, or improve tangible property, as well as to dispositions of such property. The Regulations require taxpayers to be compliant with the Regulations by the first tax year beginning on or after January 1, 2014. As such, Liberty elected to adopt the Regulations for its tax year ended December 31, 2014.

The Review focused on the application of the Regulations in four distinct areas:

- Improvements and Repairs - Treas. Reg. §1.263(a)-3
- Dispositions - Treas. Reg. §1.168(i)-1,-8
- Materials and Supplies - Treas. Reg. §1.162-3
- Acquisitions - Treas. Reg. §1.263(a)-1 and -2

**COMPANY OVERVIEW**

Liberty Utilities, whose parent company is Algonquin Power and Utilities Corp. ("APUC"), is a diversified rate regulated utility providing electricity, natural gas, water distribution and wastewater collection utility services to approximately 480,000 connections. Liberty Utilities provides safe, high quality and reliable services to its ratepayers through its nationwide portfolio of utility systems and delivers stable and predictable earnings to APUC. In addition to encouraging and supporting organic growth within its service territories, Liberty Utilities delivers continued growth in earnings through accretive acquisition of additional utility systems.

The utility systems owned by Liberty Utilities operate under rate regulation, generally overseen by the public utility commissions of the states in which they operate. Liberty Utilities reports the performance of its utility operations through three regions – West, Central, and East.

The Liberty Utilities (West) region is comprised of regulated electrical and water distribution and wastewater collection utility systems. The regulated electrical distribution utility and related generation assets (the "CalPeco Electric System") serve approximately 47,800 electric connections in the State of California. Liberty Utilities (West) region's regulated water and wastewater utility systems serve approximately 68,000 water and wastewater connections located in the State of Arizona.

The Liberty Utilities (Central) region is comprised of regulated natural gas and water distribution and wastewater collection utility systems. The regulated natural gas utilities serve approximately 85,600 natural gas connections located in the States of Missouri, Illinois, and Iowa. Liberty Utilities (Central) region's regulated water distribution and wastewater collection utilities serve approximately 29,400 water and wastewater customers located in the States of Arkansas, Illinois, Missouri, and Texas.



Liberty Utilities (East) region is comprised of regulated natural gas and electric distribution utility systems located in the State of New Hampshire, and regulated natural gas distribution utility systems located in the States of Georgia and Massachusetts. Liberty Utilities provides regulated local electrical utility services to approximately 43,800 electric connections in the state of New Hampshire; and regulated local gas distribution utility services to approximately 206,200 natural gas connections located in the states of Georgia, New Hampshire and Massachusetts.

## **METHODOLOGY**

EY provided technical guidance to the Company related to the analysis of materials and supplies, acquisitions, improvements, repairs, unit of property and dispositions. EY and the Company performed the assessment analysis for materials and supplies, acquisitions, improvements, repairs previously deducted, repairs previously capitalized, and dispositions to determine the effect of these items on the Company. EY was involved in discussions related to the Company's analysis and reviewed the conclusions to ensure that the positions taken are reasonable. EY made recommendations on which method changes and elections to file pursuant to the Regulations; however the Company will make the ultimate decision on the method changes and elections filed.

## **IMPROVEMENTS AND REPAIRS**

The following summarizes the assessment analysis steps for the Improvements and Repairs section of the Regulations.

### ***Technical Summary***

The Regulations require betterments, restorations, and adaptations of a unit of property to a new or different use to be capitalized for tax purposes. The Regulations define the unit of property, unless otherwise specified, based on the functional interdependence standard. Components are considered functionally interdependent if the placing in service of one component depends on the placing in service of another component. The Regulations provide special rules for buildings, plant property, network assets, leased property, and improvements to property. Under the Regulations, each building and its structural components are a single unit of property. However, when applying the improvement standards, the building structure and eight major building systems are evaluated as separate units. Under the Regulations the units of property for plant equipment are the components (or groups of components) of functionally interdependent property that perform a discrete and major function or operation within the functionally interdependent property. Rev. Proc. 2011-43 provides a safe harbor for determining the units of property for electric transmission and distribution property and determining whether replacements to this type of property qualify for a repair deduction.

The regulations provide routine maintenance rules for both building and non-building property. The routine maintenance safe harbor for buildings covers repair and maintenance items that are reasonably expected to be performed more than once during the 10-year period beginning at the time the building structure is placed in service. The routine maintenance safe harbor for non-building property covers repair and maintenance items that are reasonably expected to be performed more than once during the ADS class life of a unit of property.

The Regulations also provide an annual election that allows a taxpayer to capitalize all repair and maintenance expenditures that it treats as capital expenditures for financial accounting purposes.

### ***Information Gathered***

The following information was utilized during the assessment analysis:

- Liberty Utilities capitalization policy document for financial reporting
- Work order listing of all 2013 additions with job type descriptions for each work order for the following entities:



- Peach State Natural Gas (Georgia)
- Midstates Natural Gas Corp
- Granite State Electric
- CalPeco Electric Systems
- Pine Bluff Water
- New England Natural Gas (no 2013 additions – Susan to confirm)
- Liberty Water Company (data outstanding but 481(a) adjustment is not expected to be material)
- Energy North Gas Company (not included as repair analysis already completed)

### **Analysis Performed**

During the assessment analysis, EY performed the following:

- EY reviewed the capitalization policy to determine how improvements and repairs are being determined for property other than transmission and distribution network property.
- EY confirmed with the Company that the listing of 2013 additions agreed to the 2013 tax return.
- EY excluded any work orders not related to transmission and distribution network property using the FERC accounts associated with each work order.
- EY reviewed the job type descriptions for each work order to determine if the type of work performed on that work order was potentially qualifying as a repair under the Regulations and Rev. Proc. 2011-43 (if applicable)
- EY conducted discussions with knowledgeable personnel from Liberty Utilities to confirm that activities performed for work orders with larger dollar values (greater than \$500,000) or where the type of work performed was not clear from the job type description.
- Based on the analysis above, EY calculated an estimated Section 481(a) adjustment for the implementation of the improvement and repairs sections of the Regulations.

### **Conclusions**

The following summarizes the conclusions based upon the analysis performed:

- All assets other than transmission and distribution network property:
  - The Company's book capitalization policy states that the purpose for "capitalizing" expenditures as capital assets is to provide for an equitable allocation of costs among existing and future customers. As assets are expected to provide "future economic benefits", expenditures incurred for the acquisition, construction or development of assets should be capitalized and allocated over the estimated useful lives of the associated assets in the form of amortization / depreciation. Accordingly, expenditures relating to the acquisition, construction or betterment of an asset, should be capitalized as an asset, and all other expenditures should be expensed in the accounting period incurred.
  - Based on the Company's book policy, discussions with the Company, and review of the selected fixed asset reports, we believe the Company does not have a material exposure related to their repairs deductions. The Company considers each repair expense and whether or not it is capital in nature based on if it is a replacement of a retirement unit (capital) or replacement of a minor item of property (repair). A minor item of property is a part, piece, section or portion of the retirement unit component with which it is associated. It is always capitalized when originally installed as part of a retirement unit, and always expensed when replaced independent of its associated retirement unit.
- Transmission and distribution network property:
  - As a result of the analysis described above a gross (before depreciation offset) Section 481(a) adjustment of between \$18,000,000 and \$21,000,000 was determined for repairs that have been capitalized in prior years that can be deducted as a repair for tax purposes under the Regulations.

- Bonus and regular depreciation on the above estimate will need to be calculated and offset once it is determined which entities elected out of bonus depreciation in prior years, if any.
  - As noted above, this estimate does not include Liberty Water Company as this data has not been received to date. We do not anticipate a material Section 481(a) adjustment for Liberty Water Company.
- EY recommends that the following accounting method change is made related to the improvements and repairs sections of the Regulations:
  - Automatic accounting method change number 184 – A change to deducting amounts paid or incurred for repair and maintenance including a change in the method of identifying the unit of property for the purposes of making this change.





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**Date:** January 6, 2016

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Susan Wan, Senior Manager, Algonquin Power & Utilities Corp.

**From:** Mike Reno, EY, Washington, DC  
Shane Attlee, EY, Syracuse, NY  
DaShawn Babbs, EY, New York, NY

**cc:** Susan Graiss, EY, Washington, DC  
Thomas Ribitzki, EY, New York

**Subject:** Liberty Utilities (America) Co. Tangible Property Regulations -  
Process Memorandum

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Any U.S. tax advice contained herein was not intended or written to be used, and cannot be used, for the purpose of avoiding penalties that may be imposed under the Internal Revenue Code or applicable state, local, or foreign tax law provisions.

## I. INTRODUCTION

Ernst & Young LLP ("EY" or "we") was engaged by Liberty Utilities (America) Co. ("Liberty Utilities") to provide tax advisory services related to the final tangible property Treasury Regulations and accompanying guidance on capitalization of costs related to tangible property as they relate to U.S. federal income taxation ("Tax"), which occurred in two phases. As part of Phase I of the project, EY gathered information necessary to understand Liberty Utilities' current financial reporting and tax methodologies, policies, and processes and to perform a preliminary analysis of the impact of the tangible property regulations<sup>1</sup> on Liberty

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<sup>1</sup> Except as otherwise noted, all references to "Section(s)" or "§(§)" refer to the U.S. Internal Revenue Code of 1986, as amended ("Code") and to the regulations promulgated thereunder ("Treas. Reg. Section(s)" or "Treas. Reg. §(§)"). References to the "IRS" or "Service" are to the Internal Revenue Service. In addition, as noted in the Technical Memo, the final tangible property regulations issued



Utilities. EY compared current methodologies with the regulations, and developed a work plan to effect the adoption of the regulations. EY also calculated an estimated Section 481(a) adjustment relating to the adoption of the tangible property regulations (refer to Phase I Memo for more information regarding Phase I procedures, methodology, and findings).

As part of Phase II of the project, EY (1) calculated the 2014 repairs deduction for each applicable entity in the Liberty Utilities Consolidated Group including the 2014 repairs deduction for Energy North Natural Gas ("Energy North") under its established method (2) finalized the Section 481(a) adjustment calculation related to the repairs accounting method change based on updated data received from each applicable entity in the Liberty Utilities Consolidated Group, and (3) using the TPR Organizer (EY's proprietary TPR software tool), assisted Liberty Utilities with the preparation and filing of Form 3115, Application for Change in Accounting Method in order to implement the tangible property regulations. In addition, EY provided Liberty Utilities with (1) this process memorandum ("Process Memo"), documenting our methods and procedures with respect to the project, the information provided by Liberty Utilities that we analyzed, and Liberty Utilities personnel with whom we consulted, and (2) a technical memorandum ("Technical Memo") documenting the authority for our conclusions set forth in the Process Memo.

## II. SCOPE

This Process Memo is limited to the Tax issues specifically addressed herein. The Process Memo supersedes and replaces any and all prior written or oral advice regarding the Tax treatment of the issues addressed described herein, and no such prior communications should be relied upon for any purposes whatsoever, including (without limitation) the preparation, filing or delivery of any tax returns, information return or statement or other attachment related to (or filed or required to be filed with) any such return.

In preparing this Process Memo, we have relied upon information provided by Liberty Utilities for purposes of our analysis. We have made no independent determinations and, therefore, have relied on the completeness, truth, and accuracy of such information as providing an accurate and complete description of all of the facts and circumstances in all material respects relevant to our conclusions stated herein. If there are any inaccuracies in, omissions from or modifications to such information, if any of the foregoing is incomplete in any material respect, or if any related transactions occur that are not described herein, the Process Memo could be materially and adversely affected, perhaps rendering it inapplicable.

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September 19, 2013 and August 18, 2014 are hereinafter referred to as the "regulations," unless otherwise noted.





Our conclusions stated herein are based upon our analysis of the Code, Treasury Regulations, relevant decisions by the courts, and interpretations provided by the IRS existing on the date hereof (the "Existing Law"). Our conclusions reflect our interpretation of the Existing Law and, as such, are not binding on the IRS or the courts. The Existing Law is subject to change, and any such change may be retroactively effective, and may adversely affect our conclusions. Nothing in our conclusions should be construed as imposing any obligation on EY to inform you, or any other interested party, of subsequent developments, or otherwise update the Technical Memo for changes in law, facts or circumstances occurring subsequent to the date of the Technical Memo.

### III. PROCEDURES PERFORMED

As mentioned above, the project was completed in two phases. As part of Phase I, EY (with the assistance of Liberty Utilities) developed an understanding of current capitalization methodologies, policies, and procedures. EY gathered information necessary to understand current financial reporting and tax methodologies, policies, and processes and to perform a preliminary analysis of the impact of the new regulations on Liberty Utilities. EY held discussions with Client's tax, financial accounting, and operations personnel to discuss the information gathered as well as to understand policies related to tangible property, operations and systems. Refer to Appendix A for a list of Liberty Utilities contacts that were utilized for this project. EY used its findings in Phase I to complete the analysis and filing of the Form 3115 in Phase II.

Phase II involved a more detailed review of Liberty Utilities' capitalization policies, preparing and filing accounting method changes (Form 3115) and elections to comply with the regulations. As discussed above, EY utilized the TPR Organizer to prepare the Form 3115. The assessment report generated by the TPR Organizer recommended that the following accounting method changes be included in the Form 3115 for adoption of the tangible property regulations (refer to Appendix C for a summary of Applicants for each Accounting Method Change):

- **Change 184** - Deducting repair and maintenance costs, or capitalizing improvements to tangible property and, if depreciable, depreciating such property under section 167 or section 168. Includes change(s) to unit(s) of property, a change to adopt the routine maintenance safe harbor, and change(s) to the treatment of removal costs related to property that is not disposed of for tax purposes.



Phase II also involved computing repairs deductions for each applicable entity in Liberty Utilities consolidated group. The consolidated group includes several entities involved in the following principal business activities: water and sewer distribution, natural gas distribution,



and electric power distribution. Please see below for the process that EY used to compute the Section 481(a) adjustment and the 2014 repairs deduction for each of the three principal business activities.



## **B. Electric Process**

EY obtained fixed asset additions data for the tax years ended 12/31/2013 and 12/31/2014 for the two electric entities in the Liberty Utilities Consolidated Group-Granite State Electric and CalPeco. Both electric entities were recently 100% acquired, and only had fixed asset additions starting in 2013, with no prior history of repair activity predating 2013. The Section 481(a) adjustment, therefore, only included 2013. As part of the TPR implementation process, the electric entities were adopting the Electric T&D safe harbor provided in Rev. Proc. 2011-43 for the 2014 tax year. EY only analyzed assets covered by Rev. Proc. 2011-43 (network assets). All other assets were removed from the analysis.

Through discussions with Liberty Utilities, and analyses of job type fields, all work orders related to new business and/or growth as well as any of the “per se capital” project types under Rev Proc. 2011-43 (e.g., overhead to underground conversion, material extension of the circuit etc.) were classified as non-qualifying, and no further work was performed on these work orders.





The 10% test under Rev. Proc. 2011-43 was then performed on each of the remaining work orders. For each replacement of a portion of a unit of property, it was determined whether more than 10% of the unit of property was replaced. If more than 10% of the unit of property was replaced, the cost of the replacement was capitalized as an improvement. If 10% or less of the unit of property was replaced, the cost of the replacement was deducted as a repair. To perform the 10% test, the applicable unit of property for each work order was determined using the asset ID and description information in each work order. Most work orders involved more than one UOP type per work order. For example, one work order could involve the replacement of both conductor and poles. These UOP types were kept separate in order to perform the 10% test for conductor and poles separately for the work order. If there was more than one line item within the work order related to a single UOP type, then the quantities for each line item were aggregated for the purposes of the 10% test.

Based on conversations with Company engineers, EY determined that no additional work orders needed to be aggregated based on the aggregation rules of Rev. Proc. 2011-43. For the numerator in the 10% test, the quantity on the work order for each UOP type was used.

For the denominator in the 10% test, GIS data provided by Liberty Utilities was used to determine the total number of length/units of each UOP type (poles, conductor, conduit, etc.) for each circuit. If the specific circuit ID was available in the system, each work order was then matched to the appropriate circuit using this circuit ID. If the specific circuit ID was not available, the transition rule of Rev. Proc. 2011-43 was used whereby the denominator in the 10% test was determined using the average UOP type within a county. The average UOP type within a county was calculated by dividing the total of each UOP type within a county by the total number of circuits in that county (all this information was provided in the GIS data provided by Liberty Utilities).

Any work orders that failed the 10% test were classified as non-qualifying, and no further work was performed on these work orders. All work orders that passed the 10% test were then considered qualifying. The above process relates to fixed asset additions as computed for book purposes. The total qualifying amounts in 2013 and 2014 were then adjusted for the proportional amount of book/tax differences so that we were left the total repairs deduction for tax purposes. The 2013 deduction amount was then reduced for bonus depreciation and



adjusted for one year of regular depreciation to determine the 481(a) adjustment for each entity.



#### IV. CONCLUSION

Based on our review of data provided by Liberty Utilities and Company discussions, EY has recommended that the following accounting method changes be made in order to implement the Regulations:

- **Change 184** - Deducting repair and maintenance costs, or capitalizing improvements to tangible property and, if depreciable, depreciating such property under section 167 or section 168. Includes change(s) to unit(s) of property, a change to the routine maintenance safe harbor, and change(s) to the treatment of removal costs related to property that is not disposed of for tax purposes.



EY also calculated the Section 481(a) adjustment for expenditures under the electric transmission and distribution safe harbor method for repairs and maintenance under Rev. Proc. 2011-43 and determined the adjustment to be \$2,540,754. See Appendix B for the Section 481(a) adjustment for all entities.

## Appendix A - Liberty Utilities Contact Listing

Name	Entity	State	Industry	Title	Email
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Ken Wittman	CALPECO	California	Electric	Accounting Manager	Ken.Wittman@libertyutilities.com
Mike Long	CALPECO	California	Electric	Rate Case Consultant	Mike.Long@libertyutilities.com
Jeff Kijanka	CALPECO	California	Electric	Senior Accountant	Jeff.Kijanka@libertyutilities.com

## Appendix B - Section 481(a) adjustment Summary

### Liberty Utilities Repairs Analysis For Years 2013 & 2014

Company	FEIN	2012	2013	Section 481(a) Adjustment	2014
<u>Electric</u>					
Liberty Utilites Co.	27-4444001		1,502,496.03	1,502,496.03	3,258,587.11 (Calpeco)

## Appendix C

Summary of Applicants for each Accounting Method Change

Company	FEIN	Designated Change Number							
		160	184	186	187	190	191	192	206
Liberty Utilites Co.	27-4444001	X	X	X	X	X	X	X	X

(Calpeco)